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ABSTRACT

This paper examines recent efforts in Arkansas to nullify property taxes. It describes how anti-tax citizens, whose push for a constitutional amendment in 1998 was thwarted by the state supreme court, have vowed to collect enough signatures to place the amendment on the 2000 ballot. The proposed amendment will abolish ad valorem taxes upon real and personal property; will prevent the General Assembly or any local government from imposing or increasing any tax, fee, or other exaction; and will repeal all laws and constitutional provisions that conflict with the amendment. In Arkansas, property taxes are a major source of funding for education, with projected revenue in 1999 expected to be $983.3 million. Even so, the state ranked 47th in property taxes as a share of personal income and as a percentage of funding for schools through property taxes--only six states' property taxes are lower than Arkansas. Estimates of the impact, should the proposed amendment pass, show that public schools would lose $425.7 million. School officials are concerned that if the amendment passes, school construction will be halted, revenue streams will become unstable, increased state funding will result in less local control of public education, and sharp reductions in the quantity and quality of education will become evident. (RJM)

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# The Arkansas Nightmare

A paper delivered at the American Education Finance Association Meeting,
Seattle, Washington, March 17-20, 1999

by

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There must be something meaningful in the close proximity of Halloween to Election Day. In 1998, this meant in Arkansas either the exorcism of a hobgobblin or the advent of a permanent ghost that would have destroyed school finance. For the ghost that haunted the election and could haunt the future is the repeal of the property tax.

Although much of the state of Arkansas is actually losing population, the northwest corner has become a boom area. It has for many years been a growing retirement community. More recently the development of tourism and the local food processing industry, as well as more retirees courtesy of *Modern Magazine*, have led to population growth and a housing shortage. In accordance with Wagner's Law more money had been required for public services. The property tax had been a major source. Property had increased in value. Arkansas law requires that if the county's assessment ratio as sampled by a state agency falls below 18 percent of use value then the county must have its property reassessed.

As a result, some citizens, especially retirees, found taxes increased. This incensed them. They got together with some other low tax supporters and determined to collect enough signatures to have a Constitutional Amendment placed on the November 1998 ballot to end the property tax.

Strangely they succeeded in doing this. As a result, Amendment 4 did originally appear on the ballot. Not only did it repeal the property tax, it set limits on the sales tax and *mirabile dictu* required that all taxes be voted upon in every general election. This means that every two years the voters will approve or disapprove taxes.

The immediate result of the idea, should it be adopted is that Arkansas will try to educate its children with over $400 million per year less, thus making by far the lowest per pupil expenditures in the nation.

Election Day passed without a decision. Although the Amendment title appeared on the ballot, the votes regarding it were not counted. This is because a few days before, a suit brought by an organization of opponents of the Amendment was heard by the state Supreme Court. The Court decided that there were not enough legal signatures on the petition to have the Amendment put on the ballot. As a result, nothing happened.

However, the zealots for the proposal are already promising to collect sufficient proper signatures of voters so that the Amendment will appear in November 2000.

The title of the proposed Amendment is as follows:

**An amendment to abolish ad valorem property taxes, authorize the increase of sales and use tax, require periodic voter approval for certain local sales, use, and occupation taxes, limit state and local regulation, and for other purposes.**

**What Does the Amendment Do?**

1. The Amendment abolishes all ad valorem taxes upon real and personal property, abolishes all fines or penalties related to property taxes, discharges all personnel employed in the collection of property taxes, and closes or converts to other use all offices used in collecting property taxes.
2. Authorize the general assembly to levy sales and use taxes of not more than ½% dedicated to be turned back to counties and municipalities on a per capita basis--one-half of which must be dedicated to the construction and maintenance of roads and bridges.

3. Authorizes the General Assembly to levy sales and use taxes of not more than 7/8% dedicated to primary and secondary education.

4. Prevents the General Assembly or any local government entity from imposing or increasing any tax, fee, or other exaction, or divert fuel taxes or other revenue sources presently used for roads and bridges, without the approval of a majority of the qualified electors of the state or the affected local government entity at a regularly scheduled statewide election.

5. Prohibits the reduction or elimination of exemptions or credits, or changing any law or rule, which results in the collection of additional revenue from some or all taxpayers.

6. Permits any county to levy a permanent sales and use tax, when once approved by the qualified voters at a regularly scheduled statewide election, not to exceed ½% distributed on a per capita basis of the county and municipal population.

7. Authorizes additional county or municipal sales and use taxes, and all taxes upon the carrying on of lawful trades, useful occupations, or learned professions, but only with the continuing approval of the voters at each regularly scheduled statewide election. This provision excludes taxes dedicated exclusively to the retirement of debt lawfully contracted prior to January 1, 1999, and the limitations of this section applies only to taxes collected on or after January 1, 2001.

8. Prohibits the State of Arkansas or any of its subdivisions from making or enforcing any law or regulation of business, commerce, trades, employment, or environmental matters, if the law is detrimental to the financial well-being of the regulated person or entity, or the taxpayers at large, unless the proponent of the

state law or regulation proves that the law or regulation is reasonably necessary and effective to protect a substantial state interest, and the opponent of the law or regulation fails to prove that an alternative less costly to the citizenry would reasonably protect the State's interest.

9. Provides that the terms of the Amendment shall be liberally construed and interpreted in favor of the taxpayer.

10. Repeals all laws and constitutional provisions which conflict with the Amendment.

**What is the total revenue produced by the property tax?**

In 1997, total revenue that would have been produced by the property tax at a 100% collection rate for schools, cities, counties, public libraries, etc., was $895 million. It is estimated by the Arkansas Assessment Coordination Division that the revenue generated for schools, cities, counties, libraries, etc., in 1999 will be $983.3 million.

**What is the revenue for public elementary and secondary education produced by the property tax?**

In 1997, the property tax would have produced $675 million for the state's elementary and secondary schools at a 100% collection rate (75.4% of the total revenue produced by the property tax). In 1998, it is projected by the Arkansas Assessment Coordination Division that the property tax will produce $706 million (85.8%) for the public schools; and in 1999, it is anticipated that the property tax will generate at least $745 million (75.8%) for the public schools.

**How does the property tax in Arkansas compare to the property tax in other states?**

According to a report by the Winthrop Rockefeller Foundation published in January 1997, entitled "Building a Better Tax System," Arkansas ranked 47th in property

taxes as a share of personal income, lower than all of its neighboring states. Between 1980 and1993, property taxes in Arkansas fell by 12 percent as a share of personal income, while property taxes nationwide rose by 11 percent as a share of income.

**How does funding for public education in Arkansas from property tax revenue compare to funding for education from property tax revenue in other states?**

According to an annual report published by the National School Board Association in the December 1997 issue of the American School Board Journal, the property tax in Arkansas in 1996-97 produced 25.7% of school revenue. The national average of school revenue produced by the property tax is 44.2%. As a percentage of funding for schools through property taxes, only six states are lower than Arkansas. All of the states adjoining Arkansas have a higher percentage of funding for schools through property taxes.

**What is the current and projected revenue produced by the state sales and use tax?**

In fiscal year 1997, according to the Arkansas Department of Finance and Administration, the state sales and use tax generated $1.418 billion, or $315.1 million for each penny of state sales tax. In 1999, when the proposed Amendment would become effective, it is estimated by the Department of Finance and Administration each penny of state sales tax will generate $342.6 million.

If the proposed Amendment is approved, and the General Assembly levies the maximum increase in the state and use tax of 1.375%, it is estimated by the Department of Finance and Administration that an additional $471.1 million will be generated in1999 ($342.6 million).

**What is the revenue for public elementary and secondary education produced by the increase in the sales and tax?**

The proposed Amendment provides that 0.875% or 7/8 of one cent of the increase in the sales and use tax shall be dedicated to primary and secondary education. It is estimated this will produce $299.8 million for the public schools in 1999 ($342.6 times 0.875).

**How does the sales and use tax in Arkansas compare to the sales and use tax in other states?**

According to a report by the Winthrop Rockefeller Foundation published in January 1997, entitled "Building a Better Arkansas Tax System," Arkansas sales and excise taxes are high compared to other states, ranking 11th nationwide as a share of personal income and 9th as a share of total tax revenues.

**What is the impact of the proposed Amendment on public elementary and secondary schools?**

Based on 1998 data compiled by the Arkansas Assessment Coordination Division, the public schools would lose $425.7 million. In 1999, it is projected that the property tax would produce $745.0 million for public education. The increased sales tax of 0.875 cent is projected to produce $299.8 million in 1999. If the General Assembly does not divert funding from other sources to the Public School fund, the revenue loss in1999 would be $445.2 million. The loss per student would be $984.69 ($445.3 million divided by 452,121 students).

**How does Arkansas compare with other states in expenditures per student?**

The National School Board Association reports that Arkansas expended $4,498 per student in 1996-97. According to the report, only two states—Arizona and Utah—

spend less per student than Arkansas. The national average expenditure per student is $6,327—$1,829 per student more than the per student expenditure in Arkansas.

**In addition to the loss of revenue, what are other concerns of school officials?**

- Currently, the construction of school facilities are approved by the voters in local school districts and financed by revenue from the property tax. In 1997, public schools in Arkansas had a total debt of $899.7 million. The annual debt payment is $91.4 million. The security for the bonds sold by school districts to provide funds for construction comes from property tax revenue. If the Amendment is approved, how would school construction be funded? How would the security for the school bonds be affected?
- The property tax is a more stable source of revenue than the sales tax. If schools are funded primarily by revenue from sales and use taxes and individual and corporate income taxes, revenue for schools will be less stable as changes occur in the economy.
- With all funding coming from the state, there will be less local control of public education. Local citizens will have no opportunity to vote for the construction of needed school facilities or to provide a higher level of funding for instructional programs at the school district level.
- Recently, the Supreme Court declared the school finance system in Arkansas to be unconstitutional. As a result, the General Assembly enacted a new school finance formula designed to provide a more equitable funding system. As a part of the new funding system, the voters of Arkansas approved a Constitutional Amendment to levy

a 25 mill tax statewide. If the property tax is abolished, what will be the impact with regard to a constitutional system of funding public education?

- It is estimated that Arkansas taxpayers enjoy a $50 million per year benefit by being able to deduct their property taxes from the federal income tax. This benefit would not exist if the property tax is eliminated and the sales tax increased.
- At the present time, corporations, industries, and utilities pay approximately $360 million annually in property taxes. If the Amendment were to be approved, these taxes would be shifted from business and industry to individual consumers.
- The elimination of the property tax would create great uncertainty and confusion immediately, and citizens would soon experience sharp reductions in the quantity and quality of elementary and secondary education programs and vital city and county public services.

**What will it do to School Districts?**

In addition to the legal and fiscal problems already mentioned, such repeal would question the entire administrative structure of schools. If all financing comes from the state, the funds will be divided on an ADM or ADA basis. Therefore, there is little need for a local school board as it will no longer be able to request millages and develop budgets. As a result, there is no need for districts or superintendents. All individual schools can be funded directly, much as Hawaii. They would completely reorganize education in the state. The state board of education will be the sole school board and the state department of education will be the fiscal source. That department will have to be enlarged to help each school develop a budget. Site-based management will have arrived but there will be little local input.

Another function that will go to the state level is facilities. There will have to be state boards and a method for developing properties in the construction of buildings. Local workers will be ignored. As a result, Arkansas will look a lot like Hawaii but without the wealth.

**What is happening now?**

The Governor and Legislators were concerned about the dislike of the Property Tax, especially after a poll in the fall of 1998 showed a majority of voters in favor of repeal. Suggestions have ranged from a 20 thousand dollar Homestead Exemption for property owners over 65, to a freeze on property taxes for the elderly, to a maximum use of 10 percent per year, to payment over time, to low income tax payers getting a refund.

A poll taken in January 1999 tends to refute the 1998 poll. It claims that only 26 percent of the voters want complete abolition of the tax while the other group wanted some changes made. Losses are still to be made up by an increase in the sales tax.

Just to further confuse the problem, the State Senate passed a bill repealing the sales tax on food. This would mean that a confirmation of such a repeal and the Amendment would create a huge tax on all other goods.

The zealots are already collecting signatures. The future looks awfully uncertain.